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YEAR-END TAX PLANNING

All things being equal, the rumored increase in individual and corporate tax rates in 1967 should play an important part in year-end tax planning. Admittedly, the shifting of income and deductions may fall short of the goal in the absence of knowledge as to the actual new rates, but present thinking tends toward the belief that the change will not be too drastic. Under these circumstances the present tax bracket of the taxpayer should be carefully studied. If in 1966 an individual is at the lower level of a particular tax bracket, it may pay to accelerate income or defer deductions to the extent of the range in that bracket, as all of the income will be taxed at the same rate. If the reverse is true, however, it would be foolhardy to increase current year's income, putting the taxpayer in a higher bracket. Of course, if a tremendous increase in income is anticipated, relief will be afforded under the income-averaging provisions of the Code.

We are all acquainted with the basic principles involved in shifting of income and deductions, and the relative simplicity of shifting income for cash basis taxpayers, as compared to those employing the accrual method. For that reason, only in a few areas, where a new element has entered the picture, will tax planning be discussed.

Contributions:

One way of reducing income, if that is the indicated move, is to make charitable contributions to the fullest extent allowable. The caveat here is, of course, Section 170(e) of the Internal Revenue Code which requires the reduction in the fair market value of a gift of property to the extent of recapture of depreciation under Sections 1245 and 1250. This means that if you transfer property which has appreciated greatly in value, the benefits of this appreciation may be lost when that value is reduced by the amount of depreciation taken after December 31, 1961 in the case of Section 1245 property, and after December 31, 1963 for Section 1250 property. Similarly, early disposition of property to a charity may result in the recapture of the investment credit under Section 47 of the Internal Revenue Code.

The five-year carryover rule as applied to individuals should, in most instances, prove helpful. A large gift of property can be made in 1966 to an institution of the so-called 30% type, and the excess over the current year's limitation may be carried over and utilized in five successive tax years. This will serve to level off income in those years, in that any increase in adjusted gross income will carry with it an increase in the contribution deduction. Caution must be exercised in determining those charities which meet the 30% requirement of receiving a substantial amount of their support from the general public (*Tax Forum,* October 1966 issue, THE WOMAN CPA).

Year-End Distributions:

Once earnings have accumulated to the $100,000 mark, every corporation that is closely held must give consideration to dividend distributions that will eliminate the possibility of a tax on undistributed earnings under Section 531 of the Internal Revenue Code. On the other hand, the shareholders, if already in high brackets, tend to resist receiving additional income. The conflict of interests looms large at year-end; and if retention of profits by the corporation is to be justified, the reasonable needs of the business must be established. In a year in which it is deemed expedient to forego distributions, the business purpose must be carefully documented in the minutes and subsequently reinforced by definitive action by the corporation to utilize the funds retained. Where no substantial business purpose could justify retention of earnings in the past, it was felt that a liberal dividend policy would circumvent Section 531. This reasoning was recently upset in *Henry Van Hummell, Inc. v. Commissioner, U.S.C.A. (10th Circuit) No. 8104* where the taxpayer had paid out over a thirty-year period an average of approximately 60% of its net income after taxes. Although the Court commented upon the liberality of dividend payment history, nevertheless it ruled in favor of the Tax Court because of lack of business purpose to justify the retention of any net earnings. If that situation obtains, it may be well to declare and pay a dividend prior to the close of the current year in order to bring the shareholder's income into the year of a lower tax rate. The corporation will get credit for the current year's payment, and any payment within two and one-half months after the close of the year, in determining vulnerability to Section 531. The shareholder will be able to average income to his advantage in the two years.

An alternative solution to the problem of a corporation that is faced with the dilemma of a Section 531 problem is the election of Subchapter S status within the first thirty days of the 1967 year. Here, however, the shareholders are compelled to pick up in their individual returns the entire net income of the corporation whether or not distributed. The election negates the possibility of retention of possible future profits, should it be justified.

D.L.B.

Trends of Special Interest to the Accountant in Financial Reports

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In the booklet recently published by the American Accounting Association, "A Statement of Basic Accounting Theory," it is suggested that both historical cost and current cost be presented in adjacent columns and that current cost be secured by reference to established market price or through application of a price index to acquisition cost.

With the stress on the usefulness of financial reports comes the realization that there is a decided trend toward getting away from using technical terms that do not have precise meaning. Though there is a natural desire to reduce to a minimum the number of words used, there has been increasing growth in the footnote area and in the number of statements that show the explanations of the items directly below each title. Improvements in format, content, and other facets of the published annual report are part of management's continuous effort to maximize communication with stockholders.

In some minds, the earnings-per-share statistic is the figure that is accepted as summarizing all activity. Investment decisions are made accordingly with no consideration given to the possibility that a portion of the earnings-per-share amount may be due to income from unusual transactions and with a complete disregard of all other pertinent data. Thus, as another step in improved reporting, it is suggested that where applicable in the presentation of the earnings-per-share figure, the portion of this figure contributed by net income from operations and the remainder derived from income due to unusual transactions be separately stated. More detailed information will be forthcoming if the SEC concludes, as the result of a current study, that sales and profits for specific lines and services should be shown in detail. Concurrently, some writers of financial articles are stressing the need for presentation of individual company statements as well as the consolidated statement in cases where the individual statements are more meaningful.

The comparative financial statements that are a popular presentation in today's financial report may someday be replaced by financial statements showing a ten-year span with explanatory commentary by management as to the cause and significance of fluctuations. Increasing international business and investments augment the possibility that the present problems of uniformity and comparability in financial reports will be shifted from the local and national scene to an international setting. The present views in disputed accounting areas are surprisingly divergent, but they pose as a necessary forerunner to more profound research into what is needed. Accountants may differ as to the proper course of action, but there is evident an underlying general agreement that there will be expansion of the accounting discipline to give more information and to move ultimately toward international uniformity of accounting and auditing standards.

Financial Statements for the Transnational Enterprise

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as to currency shown. Where United States corporations hold 51% or more of the stock of a foreign subsidiary, the United States dollar is used in the statements. Companies of two foreign countries consolidating their financial statements frequently use a fictional monetary unit, such as the Eurodollar which is based on the gold standard. Finally, there are corporations whose management believes that a translation of one currency into another is not meaningful.

A Fictional Currency

As brought out above, the transnational enterprise must arrive at some common denominator in the preparation of its financial reports. Since in all likelihood a number of different currencies are involved, it seems logical that the use of a fictional currency might be of great help.

There are several advantages to employing a fictional monetary unit. The use of any one country's currency might meet considerable resistance because it would seem to give this country a special position of importance or superiority over other nationalities' interests in the enterprise. A fictional currency cannot be opposed on the basis of nationalistic feelings. Secondly, a fictional, imaginary monetary unit is not subject to fluctuating exchange rates set by national governments. If its value were related

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